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Monetary Policy Report, September 2020

The Bank of Thailand (BOT) released the September 2020 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee (MPC)'s policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the Third Quarter of 2020

At the meetings on August 5 and September 23, 2020, the Committee voted unanimously to maintain the policy rate at 0.50 percent. The Thai economy was expected to gradually recover in line with the relaxation of COVID-19 containment measures in Thailand and abroad. However, the Thai economic recovery would take at least two years before returning to the pre-pandemic level and would be highly uncertain. Nonetheless, the Committee viewed that the extra accommodative monetary policy since the beginning of the year as well as fiscal, financial, and credit measures additionally announced helped alleviate adverse impacts, and would support the economic recovery after the pandemic subsided. Moreover, a further decrease in the policy rate would be less effective in the current context and could increase vulnerabilities in the financial system. The limited policy space should therefore be preserved for the appropriate and most effective timing. Also, the Committee deemed it necessary to encourage financial institutions to expedite debt restructuring for households and businesses to have a broader impact and accelerate lending under various measures to address liquidity problems in a targeted and timely manner consistent with business restructuring.

Looking ahead, the Committee assessed that the Thai economic recovery would take at least two years before returning to the pre-pandemic level and would face high uncertainties. Moreover, the recovery would be greatly uneven among economic sectors and firms in different segments. Government policies should therefore be implemented in a targeted and timely manner to facilitate appropriate adjustments, while policy coordination among government agencies would be crucial to ensure more coherent and consistent measures. Going forward, fiscal and supply-side policies should be given a greater role in order to address excess production capacity, as well as support the changing economic structure, patterns of business operations, and labor skill development consistent with the post-COVID environment. The continued accommodative monetary policy would complement fiscal policy through low costs of borrowing and ample liquidity in the financial markets. In addition, the continuation of financial and credit measures, particularly debt restructuring, would help reduce vulnerabilities of households and businesses.

Assessment of the Economic and Financial Outlook as the Basis for Policy Formulation

1. Global Economy

The global economy was expected to contract this year due to the severe impact of the COVID-19 pandemic on private consumption and investment, as well as manufacturing production and exports. As a result, many countries, especially major advanced economies, were expected to enter a recession this year. However, the gradual relaxation of containment measures and government stimulus measures introduced in many countries could lead to a faster-than-expected recovery of trading partner economies. **The Committee thus revised up economic growth projections for Thailand's trading partners to a 4.5 percent contraction in 2020, followed by a 4.4 percent expansion in 2021. However, there remained risks that trading partner economies would underperform the baseline projection due to several factors, but the likelihood that trading partners would re-impose strict and nationwide containment measures declined.** Trading partner economies could underperform the baseline projection due to a more severe and prolonged outbreak than previously assessed as a result of an emergence of the second wave of the outbreak, greater vulnerabilities in the global financial system, and re-intensifying trade tensions between the U.S. and China. On the other hand, trading partner economies could outperform the baseline projection should the pandemic end sooner than expected, or monetary and fiscal measures implemented worldwide turn out to be more effective than expected.

Governments in various countries worldwide continued to implement monetary and fiscal measures to alleviate the economic impact of the COVID-19 pandemic. Governments continued to introduce series of relief measures aimed particularly at SMEs, households and employment. At the same time, central banks in major advanced economies continued to maintain accommodative monetary policy, including both quantitative easing and low policy interest rates. Meanwhile, some regional central banks eased monetary policy further.

2. Financial Conditions and Financial Stability

Overall financial conditions in Thailand remained accommodative. The real policy interest rate remained low compared with those in other emerging markets. Short-term interest rates in the financial markets stabilized at low levels consistent with the policy rate. Meanwhile, long-term government bond yields increased slightly in tandem with the U.S. Treasury yields and also due to bond-switching activities which contributed to a larger supply of long-term government bonds. Corporate credit spreads remained high, although the spreads of investment-grade bonds began to narrow somewhat. The minimum lending rates (MLR) remained at low levels, while the new loan rates (NLR) for corporates gradually declined, consistent with the accommodative monetary policy and as a result of soft loan programs. Corporate financing continued to expand, albeit at a slower pace as some businesses had already raised funds to increase liquidity in the previous period. With regard to exchange rates, the baht against the U.S. dollar and the effective exchange rate depreciated from the previous quarter, with high exchange rate volatilities during the third quarter in line with investors' risk sentiments. Nevertheless, the Committee assessed that if the baht were to appreciate rapidly, the economic recovery could be affected. Therefore, the Committee would closely monitor exchange rate developments in order to assess the necessity of implementing additional appropriate measures.

The Thai financial system remained highly vulnerable due to this year's economic contraction caused by the COVID-19 pandemic. This led to more vulnerable financial positions of households and businesses and consequently increased risk of defaults. However, the implementation of proactive financial and credit measures, coupled with more targeted measures, such as the DR BIZ program and the debt consolidation program for retail borrowers, would help mitigate these risks.

3. Economic and Inflation Outlook

The Thai economy was projected to contract by 7.8 percent in 2020 as the economy in the second quarter was severely affected mainly by the strict containment measures both domestic and abroad. However, latest data suggested better-than-expected developments in several economic growth components, including private and public investment as well as private consumption that gradually recovered. Nevertheless, Thailand's tourism and merchandise exports continued to contract markedly. **In 2021, the economy was projected to expand 3.6 percent**, as merchandise exports would gradually improve. Meanwhile, exports of services would recover at a slower rate as the re-opening of the country would only allow a limited number of foreign tourists. With regard to domestic demand, public expenditure would remain an important economic driver. Meanwhile, private consumption would gradually pick up, but would be restrained by vulnerable and highly uncertain household income as well as elevated household debt. Therefore, the economic recovery would take at least two years before returning to the pre-pandemic level.

Assumptions underlying the economic projection in this report are summarized as follows. First, there would be no severe second-wave outbreak of the COVID-19 in Thailand. Second, the re-opening of the country to foreign tourists would commence in the fourth quarter of 2020, but only for a limited number of tourists due to strict screening and quarantine measures. Third, there would be a widespread availability of COVID-19 vaccines in Thailand from the fourth quarter of 2021 onward.

The tourism sector would recover slowly due to the prolonged COVID-19 outbreak situation abroad. As a result, the re-opening of the country to foreign tourists would be uncertain and would only allow a limited number of tourists. The re-opening was expected to commence with the Special Tourist

Visa (STV) scheme in the fourth quarter of 2020, with strict screening and quarantine measures. The number of foreign tourists was thus projected to record 6.7 million and 9 million in 2020 and 2021, respectively.

The value of Thai merchandise exports would decline 8.2 percent in 2020. Exports to ASEAN and the Middle East remained subdued in line with the outlook of trading partner economies, while exports to major advanced economies and China started to pick up. In 2021, exports were projected to grow 4.5 percent, but the recovery would be gradual due to trade protectionist measures and slow economic recovery in trading partner economies. Moreover, a large proportion of Thai merchandise exports was affected by the COVID-19, especially automobiles, and machinery and equipment.

The current account balance was projected to register a surplus of 14.0 billion and 14.6 billion U.S. dollars in 2020 and 2021, respectively. The current account balance was revised down from the previous forecast due to a larger deficit in the services balance, mainly as a result of a sharp decline in tourism receipts. Meanwhile, trade balance would register a smaller surplus due to the increase in the value of merchandise imports, in line with larger-than-expected merchandise exports volume and domestic demand in 2021, as well as higher global crude oil prices.

Private consumption would contract in 2020 before expanding in 2021. Looking ahead, consumption was expected to expand at a slower rate than previously assessed as the labor market remained vulnerable. The number of workers unemployed or underemployed (working less than 4 hours per day) would remain high, while employed workers were expected to earn less than previously due to both lower wages and overtime. Household debt would also rise. Nonetheless, government measures would help shore up purchasing power to some extent.

Private investment would sharply decline despite better-than-expected outturns in the second quarter of 2020. The contraction would be due to high levels of excess production capacity and uncertainties surrounding the economic recovery in Thailand and abroad. Nevertheless, infrastructure investment projects, especially the public-private partnership (PPP) projects both within and outside the Eastern Economic Corridor (EEC) as well as investment in the 5G network, would help boost confidence and private investment to a certain extent. This would facilitate a gradual recovery of private investment.

Going forward, the Thai economy would remain highly uncertain and could face downside risks, depending primarily on the impact of the COVID-19. The possibilities that the economy would underperform the baseline projection would be due to the following factors. First, the global economy could enter a severe recession, which would then weigh on Thai merchandise exports. Second, Thailand could experience the second wave of the COVID-19 outbreak, triggering another round of lockdown measures in some areas. Third, the recovery of the tourism sector could be slow. Fourth, government relief measures could be delayed and smaller than expected. Fifth, balance sheets of businesses could deteriorate and thus caused many businesses to shut down permanently. Sixth, default risks of businesses and households could significantly increase. On the other hand, **there were possibilities that the economy would outperform the baseline projection** due to (1) a faster-than-expected development of COVID-19 vaccines and medicines, (2) better-than-expected impacts of additional government stimulus and credit relief measures, (3) a larger-than-expected expansion of domestic demand driven by infrastructure investment and PPP projects which could incentivize the private sector to invest more than expected, and (4) more relocations of production base to Thailand of multinational corporations thanks to Thailand's success in containing the spread of the virus.

Headline inflation was projected to be negative in 2020 mainly because of the sharp fall in oil prices in the second quarter. Nonetheless, latest data suggested that headline inflation would be higher than previously assessed. This was on account of a gradual increase in crude oil prices in response to higher oil demand, following the relaxation of containment measures in several countries, and the reduction in oil production in accordance with the agreement among major oil producers. In addition, food prices increased due to supply-side factors, while core inflation edged up because of a smaller-than-expected impact of government measures to reduce utility expenses. **The Committee thus projected headline inflation to be negative 0.9 percent in 2020 and turn positive at a level close to the lower bound of the target at 1.0 percent in 2021. Core inflation was projected to be 0.3 and 0.2 percent in 2020 and 2021, respectively.** In this regard, **there remained downside risks to headline and core inflation projections** in line with risks to crude oil prices and the economic growth projection.

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